DEPARTMENT OF STATE REVENUE

02-20130167.LOF

LETTER OF FINDINGS NUMBER: 02-20130167
Corporate Income Tax
For Tax Years 2005 through 2008

NOTICE: IC 6-8.1-3-3.5 and IC 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective as of its date of publication and remains in effect until the date it is superseded by the publication of another document in the Indiana Register.

ISSUE

I. Adjusted Gross Income Tax–Imposition.

Authority: 15 U.S.C. 381; IC 6-3-2-2; IC 6-8.1-5-1; Wisconsin Dep't of Revenue v. William Wrigley, Jr., Co., 505 U.S. 214 (1992); Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Wabash, Inc. v. Department of State Revenue, 729 N.E.2d 620 (Ind. Tax Ct. 2000); 45 IAC 3.1-1-38.

Taxpayer asserts that it does not have taxable nexus in Indiana for adjusted gross income tax purposes.

STATEMENT OF FACTS

Taxpayer is a corporation incorporated and headquartered in a state other than Indiana. Taxpayer is a wholesaler of various wireless communications equipment and accessories ("products") with a distribution center in Illinois. Taxpayer also provides third party fulfillment and logistics services for certain customers from its Illinois distribution center. Taxpayer filed its first Indiana sales tax returns in 2005. Since 2005, Taxpayer filed sales tax returns reporting several millions of dollars of Indiana sales each year. Taxpayer filed its first payroll withholding tax return in Indiana in 2005. For the 2005 tax year, Taxpayer filed two W-2s for two different employees. One employee worked the first part of the year and the second employee replaced him. For the 2006 through 2008 tax years, Taxpayer filed one W-2 for an Indiana employee in each year. Taxpayer filed its first Indiana adjusted gross income tax return in 2009.

In 2012, the Indiana Department of Revenue ("Department") conducted an adjusted gross income tax audit for Taxpayer for the 2005 through 2008 tax years. As a result of the audit, the Department determined that, based on the best information available at the time of the audit, Taxpayer had taxable nexus with Indiana for adjusted gross income tax starting in 2005. The Department issued proposed assessments for adjusted gross income tax and interest for the tax years 2005 through 2008. Taxpayer protested the proposed assessments. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

I. Adjusted Gross Income Tax–Imposition.

DISCUSSION

The Department's audit determined that, based upon the activities that Taxpayer reported on its sales tax returns and payroll withholding tax returns, Taxpayer had nexus with Indiana for adjusted gross income tax purposes for the tax years 2005 through 2008. The Department attempted to get additional information from Taxpayer during the audit, but the attempts were unsuccessful. Thus, using the best information available, the Department made adjusted gross income tax assessments for the 2005 through 2008 tax years.

Taxpayer protests the imposition of adjusted gross income tax for the 2005 through 2008 tax years. Taxpayer asserts that it did not have taxable nexus with Indiana for these years. Taxpayer maintains that its business activities in Indiana were protected by 15 U.S.C. 381 ("Public Law 86-272") until the 2009 tax year when it began filing returns in Indiana.

As a threshold issue, all tax assessments are prima facie evidence that the Department's assessment of tax is presumed correct. "The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." IC 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007); Indiana Dep't. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012).

IC 6-3-2-2(a) (as in effect for tax years at issue) provides:

(a) With regard to corporations and nonresident persons, "adjusted gross income derived from sources within Indiana", for the purposes of this article, shall mean and include:

(1) income from real or tangible personal property located in this state;
(2) **income from doing business in this state;**
(3) income from a trade or profession conducted in this state;
(4) compensation for labor or services rendered within this state; and
(5) income from stocks, bonds, notes, bank deposits, patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other intangible personal property if the receipt from the intangible is attributable to Indiana under section 2.2 of this chapter.

In the case of nonbusiness income described in subsection (g), only so much of such income as is allocated to this state under the provisions of subsections (h) through (k) shall be deemed to be derived from sources

within Indiana. **In the case of business income, only so much of such income as is apportioned to this state under the provision of subsection (b) shall be deemed to be derived from sources within the state of Indiana.** In the case of compensation of a team member (as defined in section 2.7 of this chapter), only the portion of income determined to be Indiana income under section 2.7 of this chapter is considered derived from sources within Indiana. In the case of a corporation that is a life insurance company (as defined in Section 816(a) of the Internal Revenue Code) or an insurance company that is subject to tax under Section 831 of the Internal Revenue Code, only so much of the income as is apportioned to Indiana under subsection (r) is considered derived from sources within Indiana. (**Emphasis added**).

Further, 45 IAC 3.1-1-38 states:

For apportionment purposes, a taxpayer is "doing business" in a state if it operates a business enterprise or activity in such state including, but not limited to:

(1) Maintenance of an office or other place of business in the state

(2) Maintenance of an inventory of merchandise or material for sale distribution, or manufacture, or consigned goods

(3) Sale or distribution of merchandise to customers in the state directly from company-owned or operated vehicles where title to the goods passes at the time of sale or distribution

(4) Rendering services to customers in the state

(5) Ownership, rental or operation of a business or of property (real or personal) in the state

(6) Acceptance of orders in the state

(7) Any other act in such state which exceeds the mere solicitation of orders so as to give the state nexus under P.L.86-272 to tax its net income .

As stated in Regulation 6-3-2-2(b)(010) [45 IAC 3.1-1-37], corporations doing business in Indiana as well as other states are subject to the allocation and apportionment provisions of IC 6-3-2-2(b)-(n).

These provisions outlined in regulation 45 IAC 3.1-1-38 denote a minimum threshold of activity in which an entity must engage to establish nexus with the state. Under the regulation, a Taxpayer is "doing business" in Indiana when it performs "any other acts in [Indiana] which exceed[] the mere solicitation of orders so as to give [Indiana] nexus under P[ublic] L[aw] 86-272." Without question, based upon Taxpayer's reported sales and payroll withholding activities, Taxpayer would have "taxable nexus" with Indiana unless its activities in Indiana are limited to those that qualify for protection under Public Law 86-272.

Public Law 86-272 prohibits states from imposing a net income tax on a foreign taxpayer if the foreign taxpayer's only business activity within that state is the solicitation of sales (generally referred to as "mere solicitation"). In other words, a state may not impose an income tax on income derived from business activities within that state unless those activities exceed the mere solicitation of sales. Public Law 86-272, 15 U.S.C. 381, establishes minimum standards for a state to impose a net income tax and provides, in relevant part, as follows:

(a) No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after September 14, 1959, a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:

(1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and

(2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).

. . .

(c) For purposes of subsection (a) of this section, a person shall not be considered to have engaged in business activities within a State during any taxable year merely by reason of sales in such State, or the solicitation of orders for sales in such State, of tangible personal property on behalf of such person by one or more independent contractors, or by reason of the maintenance, of an office in such State by one or more independent contractors whose activities on behalf of such person in such State consist solely of making sales, or soliciting orders for sales, of tangible personal property.

Accordingly, in every transaction, at least one state has the authority to impose tax on income derived from the sale of tangible personal property. A state could impose tax on a taxpayer if its activity within the state exceeds "solicitation of orders."

In Wisconsin Dep't. of Revenue v. William Wrigley, Jr., Co., 505 U.S. 214 (1992), the United States Supreme Court ruled in favor of Wisconsin and found that the taxpayer in Wrigley was subject to Wisconsin's net income tax because its business activities in Wisconsin exceeded Public Law 86-272's protection. Id. at 234-5. The Supreme Court explained its standard for determining "solicitation of sales," as follows:

We proceed, therefore, to describe what we think the proper standard to be. Once it is acknowledged, as we have concluded it must be, that "solicitation of orders" covers more than what is strictly essential to making requests for purchases, the next (and perhaps the only other) clear line is the one between those activities

> that are entirely ancillary to requests for purchases – those that serve no independent business function apart from their connection to the soliciting of orders – and those activities that the company would have reason to engage in anyway but chooses to allocate to its in-state sales force. [Compare] National Tires, Inc. v. Lindley, 68 Ohio App. 2d 71, 78-79 426 N.E.2d 793, 798 (1980) (company's activities went beyond solicitation to "functions more commonly related to maintaining an on-going business"). Providing a car and a stock of free samples to salesmen is part of the "solicitation of orders," because the only reason to do it is to facilitate requests for purchases. Contrariwise, employing salesmen to repair or service the company's products is not part of the "solicitation of orders," since there is good reason to get that done whether or not the company has a sales force. Repair and servicing may help to increase purchases; but it is not ancillary to requesting purchases, and cannot be converted into "solicitation" by merely being assigned to salesmen. See, e. g., Herff Jones Co. v. State Tax Comm'n, 247 Ore. 404, 412, 430 P.2d 998, 1001-1002 (1967) (no 381 immunity for sales representatives' collection activities).
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> Id. at 228-30.
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> The Court further explained:
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> By contrast, Wrigley's in-state recruitment, training, and evaluation of sales representatives and its use of hotels and homes for sales-related meetings served no purpose apart from their role in facilitating solicitation. The same must be said of the instances in which Wrigley's regional sales manager contacted the Chicago office about "rather nasty" credit disputes involving important accounts in order to "get the account and [Wrigley's] credit department communicating." App. 71, 72. It hardly appears likely that this mediating function between the customer and the central office would have been performed by some other employee – some company ombudsman, so to speak –if the on-location sales staff did not exist. The purpose of the activity, in other words, was to ingratiate the salesman with the customer, thereby facilitating requests for purchases. Finally, Wrigley argues that the various nonimmune activities considered singly or together, are de minimis. In particular, Wrigley emphasizes that the gum sales through "agency stock checks" accounted for only 0.00007[percent] of Wrigley's annual Wisconsin sales, and in absolute terms amounted to only several hundred dollars a year. We need not decide whether any of the nonimmune activities was de minimis in isolation; taken together, they clearly are not. Wrigley's sales representatives exchanged stale gum, as a matter of regular company policy, on a continuing basis, and Wrigley maintained a stock of gum worth several thousand dollars in the State for this purpose, as well as for the less frequently pursued (but equally unprotected) purpose of selling gum through "agency stock checks." Although the relative magnitude of these activities was not large compared to Wrigley's other operations in Wisconsin, we have little difficulty concluding that they constituted a nontrivial additional connection with the State. Because Wrigley's business activities within Wisconsin were not limited to those specified in 381, the prohibition on net-income taxation contained in that provision was inapplicable.
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> Id. at 234-5.

Therefore, in Wrigley, the U.S. Supreme Court established that a de minimus amount of non-solicitation activity would not cause a corporation to lose the exemption from taxation afforded by Public Law 86-272. Id. at 228-29. However, the Court also stated that a company would lose the protection of Public Law 86-272 if it performs an activity that establishes a nontrivial additional connection with the taxing state. Id. at 231-32. The Indiana Supreme Court "stated that particular emphasis should be placed upon the totality of the business activities of a company within Indiana when interpreting P[ublic] L[aw] 86-272." See Wabash, Inc. v. Department of State Revenue, 729 N.E.2d 620, 624 (Ind. Tax Ct. 2000) (citing Indiana Dept. of Revenue v. Kimberly-Clark Corp., 416 N.E.2d 1264, 1268, 275 Ind. 378, 383 (Ind.1981)).

During the course of the protest, Taxpayer submitted information about Taxpayer's sales activity. Taxpayer, in its March 14, 2013, protest letter, described its sales activity as follows:

> Taxpayer was incorporated [in a state other than Indiana] and is commercially domiciled in Illinois where its distribution center is located. Taxpayer markets and sells its products to existing and potential clients in the United States and Canada primarily through its direct sales force. To a lesser extent, Taxpayer also derived revenue from fulfillment services ("Services") rendered at its Illinois distribution center. The Services entail receiving, packaging, shipping, and triage returns for Taxpayer's third party [fulfillment and logistics customers]. From its [Illinois distribution center], [T]axpayer ships products to retail vendors and other distributors throughout the United States and Canada, including Indiana. All shipments are made via common carrier. Services were rendered solely in state of [Illinois]. Furthermore, Services were a minor part of Taxpayer's business during the audit period. For example, during 2005-2008, Taxpayer had approximately seven customers for which it provided Services and none of which were in the State of Indiana. Services were only solicited for a select group of customers that met specific criteria.

During the hearing, Taxpayer asserted that it only provided its Services to a small number of specific selected customers because the space it had available to perform its Services was limited to a small section of its Illinois distribution center for the years at issue.

During the course of the protest, Taxpayer submitted information about Taxpayer's sales personnel activities. Taxpayer, in its March 14, 2013, protest letter, described its sales personnel activities as follows:

During the audit period, Taxpayer had less than ten sales personnel located at its Illinois headquarters location. These sales personnel did not travel outside of Illinois and they solicited sales of mobile phones and accessories as well as Services. The Illinois based sales personnel performed their solicitation activities via telephone and computer.

In addition, during the audit period, Taxpayer employed four additional sales personnel that worked out of their home offices [one] in Indiana, [one in] Ohio, and two in Texas. The Indiana sales personnel's responsibility was to solicit Taxpayer's [products] to regional [retailer] accounts. His responsibilities did not include solicitation of Taxpayer's Services. Based on discussion with Taxpayer management, although the Indiana sales personnel resided in Indiana, his target customers/prospects were located solely outside [Indiana]. He spent most of [the] time traveling outside [Indiana] to solicit customers but he also worked from his home office. He was not authorized to accept orders and only performed protected solicitation activities as discussed herein.

The Ohio and Texas sales personnel similarly worked out of their home offices and solicited sales of Taxpayer's [products] . . . Solicitation of Taxpayer's Services was limited to [a] select group of Taxpayer's customers that met certain criteria, and during the audit period this activity was extremely limited. Taxpayer only had seven customers during the audit period for which it provided Services and none of these customers were based or had locations in Indiana. Based on discussions with Taxpayer Management, sales personnel would only solicit Services on specific sales trips to certain customer/prospects, so the activity was not routine. Further, Taxpayer Management had no record of its sales personal making sales trips to Indiana to solicit Services.

Taxpayer, in a memo that it provided at the hearing, asserted that the only employees that traveled away from the Illinois officer were four sales personnel that had home offices in Indiana, Texas, and Ohio. In the memo, Taxpayer maintained that the home office sales personnels' "only responsibilities were to solicit sales." Additionally, Taxpayer stated that the home sales personnel neither "provide[d] any services or technical assistance to customers nor [had] the authority to accept orders."

Taxpayer, in its March 14, 2013, protest letter, summarized its business activities during the audit period, as follows:

1. The Taxpayer's business activities in Indiana during the audit period consisted exclusively of utilizing its direct sales force to solicit orders for [products].
2. Orders for sales of the Taxpayer's [products] were sent outside of Indiana for approval or rejection.
3. If approved, orders for sales of the Taxpayer's [products] were filled by shipment or delivery from its distribution center in Illinois.
4. The Taxpayer's products were shipped exclusively via common carrier.
5. The Taxpayer did not render or solicit Services to any customers in the state of Indiana during the audit period.
6. The Taxpayer did not maintain or make use of any office or place of business in Indiana.
7. The Taxpayer did not own and/or lease, as lessor or lessee, any real or tangible personal property in Indiana.
8. The Taxpayer did not have inventories, including inventories on consignment in Indiana.
9. The Taxpayer did not use its own vehicles to ship its products into Indiana.
10. The Taxpayer did not repair or service any personal or real property within Indiana.
11. The Taxpayer did not install or assemble any products within Indiana.
12. The Taxpayer did not engage in collections activity or credit investigation within Indiana.
13. The Taxpayer did not train personnel within Indiana.
14. The Taxpayer did not bring any equipment or tangible personal property into Indiana in conducting its business activity.
15. The Taxpayer did not engage any third parties to perform the activities described in items 6 through 14 on its behalf.

During the course of the protest, Taxpayer presented a variety of documentation to support its assertions, including the job description for its home office sales personnel, the Indiana sales personnel's customer list that included the customer's locations, the description of the type of customer accounts that Taxpayer' s Indiana sales personal serviced, the customer list for Taxpayer's Services customers that included the customer's locations, copies of the contract(s) and/or billing/invoices for the independent sales representatives services that started after the audit period, Indiana sales reports for the sales occurring during and after the audit period, and documentation demonstrating Taxpayer's sales approval process.

As stated previously, the Indiana Supreme Court stated the emphasis should be placed upon the totality of the business activities of a company within Indiana when interpreting the nexus limitations of Public Law 86-272. Based upon the documentation presented, Taxpayer has provided sufficient documentation to establish that, for the audit period, its activities in Indiana either related to the "solicitation of orders," or were "non-solicitous" activities that did not rise above a de minimis level, and, therefore, Taxpayer Indiana activities are protected by Public Law 86-272. Since, based upon the documentation presented, Taxpayer's Indiana activities during the

audit period were protected by Public Law 86-272, Taxpayer did not have taxable nexus for the audit period.

FINDING

Taxpayer's protest to the imposition of adjusted gross income tax is sustained.

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